Submission by Northern Electric Company, Limited to the Royal Commission on Corporate Concentration

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Introduction

On June 24, the commission issued a statement in which it commented that the "terms of reference of the commission are broad". Indeed, they are:

"to inquire into, report upon, and make recommendations concerning:

a) the nature and role of major concentrations of corporate power in Canada;

b) the economic and social implications for the public interest of such concentrations; and

c) whether safeguards exist or may be required to protect the public interest in the presence of such concentrations."

Definition of public interest

In view of the emphasis that is being given to the "public interest", one of the commission's prime tasks should be to provide a definition for the term, at least for the purpose of its studies and report. The public interest is a term which comes easily to the mind and falls glibly from the tongue. It is also a term which has been used from time to time to justify actions which seem far removed from the public interest.

The definition of the public interest most often is in the mind of the user of the phrase and that definition appears to depend most usually more on personal interest than on the public interest.

There appears to be an assumption on the part of government that any action it takes is automatically in the public interest. This assumption is highly questionable.

What then is the public interest?

We suggest that, at any given time, the definition of the public interest on almost any given subject will vary from group to group and even from province to province. Does Quebec view the public interest in the use of Canadian oil resources in the same light as Alberta?

Almost every institution looks at the public interest from a position of self-interest or from the position of what it conceives as its responsibilities.

It is only on rare occasions that there is a consensus on what forms the public interest. Government often interprets the public interest in terms of votes and maintenance of power. Unions invariably interpret the public interest in the light of the interest of their members. Business because it has no choice, interprets the public interest through the filter of the interests of the three main publics that it serves: its customers, its employees and its shareholders.

We suggest that the commission might wish to view the public interest as that which is to the advantage, profit or benefit of the majority of the nation; in other words, the *national* interest.

A perspective on size

One of the risks of the commission's terms of reference is that its investigations into "major concentrations of corporate power in Canada" will rekindle the retelling of one of the chronic myths in Canada applied to business: that big is bad and small is good. What generally follows is that big companies should be banned.

We suggest that the best in our society is generated by, contributed to or supported by the nation's big companies. If there is a problem with big companies in Canada, that is *Canadian* big companies, it is that there are not enough of them.

The question of concentration of corporate activity will undoubtedly become confused with the question of corporate size. This will be unfortunate because growth — the principal factor in size — is not peculiar to Canadian corporations; it is shared by every healthy institution.

Political parties seek growth and spend considerable time and effort seeking adherents to their philosophies, new members and voters to support their candidates. In our society the party with the largest membership or with the largest number of people prepared to vote for its candidates is usually the ruling party. In this case, it can be said that size is a true indication of concentration of power. If the majority is large enough, as it is in at least one province, we have a concentration of almost absolute power.

Similarly, in the Canadian union movement, the objective is size and a perpetual striving for new members. Much of the growth in Canadian unions has, of course, come about by the growth in Canadian industry and Canadian industry's ability to create and support new jobs.

We believe much of the misunderstanding about the size of Canadian corporations is brought about by the distortion of perspective in which companies are seen as large in Canada — measured against a relatively small economy — but when placed against the international panorama in which they compete they are not so large.

In Canada, for instance, as measured by Canadian Business magazine, Northern Electric ranks as the 19th largest corporation. On the other hand, it ranks as only the 198th largest industrial corporation outside the United States, according to Fortune magazine. On the basis of 1974 sales it would rank as the 210th largest industrial company in the U.S.

Size is a corollary of being competitive and successful in the international markets. The governments of several countries — which, like Canada, have a future wedded to success in international trade — have deliberately created or brought about, mergers to increase the size of their national entries in such industries as steel, petrochemicals, automotive and electronics. The prospect is for further consolidation on the part of other countries as they move to protect and enhance their international trade positions.

(See Appendix B — *"Japan, Inc." — The Total Conglomerate* by John C. Lobb. This article is a reprint from the Columbia (University) Business Review of 1971 and was written following a series of lectures at Columbia by Mr. Lobb. While some of the statistics are out-dated the business methods and international competition discussed have not changed, nor, in the view of the author, has the validity of his conclusions and recommendations. Though directed originally at the United States they are just as pertinent when applied to Canada today).

Any investigation of Canadian corporate size or concentration should take place against this background of competitive international activity and need and not simply against the backdrop of the infinitely smaller scale of the Canadian economy and society. If it is not, then the true Canadian long-term national economic interest may be sacrificed for an imagined short-term public interest.

Government moves to restrict the size and growth of Canadian corporations will inhibit their ability to compete in international markets and in their domestic market as government-encouraged corporations from other countries become stronger in both arenas. Such a program can only lead to unnecessary tariff barriers around Canada raised to protect the small Canadian companies, created by legislative action.

Unless the commission believes that the form and nature of international commerce will, or can, be reversed, then it must conclude that large Canadian corporations will be an essential and desirable element of Canadian society for the foreseeable future. If, on the other hand, the commission is led to believe that small Canadian companies can compete effectively in domestic *and* international markets, or that Canada's future is not in international trade it may draw different conclusions.

Benefits of size

It is reasonable, at this point, to ask whether apart from the ability to compete more effectively in essential international markets, there are any benefits to size; benefits that are in the national interest. The answer is yes, and the benefits are many. In fact, without the big Canadian corporation, Canadian society would be less developed, less effective and less dynamic.

There is the obvious benefit that big companies create big projects and big employment opportunities. While it is customary for union and political leaders to point with pride to improvements in employee and social benefits, it should be noted that these improvements came about only because of the willingness and ability of large companies to provide them. They all cost money and this money has usually been raised by the skill of the management of the companies concerned.

Only government can increase its revenue by decree to pay for social benefits *but* government can do this effectively *only* if there are successful big companies generating profits to be taxed and creating jobs to provide income to be taxed.

There is hardly a social service organization in Canada that is not a recipient of the generosity of business. Though Canadian corporations do little to publicize their corporate philanthropy, many big companies have at least one full-time manager dealing with their contributions programs.

Without belittling the role played by governments at all levels in the support of the arts, the growth of higher education and the nation's universities, it is no exaggeration to say that university growth would cease and the arts in Canada would atrophy without the financial support that is rendered by big business on a national basis.

With rare exception — when a specific donation is made for a specific purpose — corporate donations are made without strings attached, in contrast to many government contributions which are hedged with qualifications, restraints and requirements.

The boards of social service organizations, united appeals, museums, hospitals, symphony orchestras, art galleries, community theatres, universities and similar institutions would be decimated if its members from the business community were withdrawn. The executives from big Canadian corporations are usually the men who play the leadership role in raising funds for the community or national organizations they represent.

Big successful companies are the companies that attract the best management or management candidates. This is not to say that there is not good management in small companies but, all things being equal, an ambitious person is likely to go where the growth opportunities are greatest, and that usually is with a large company.

The ambitious and talented gravitate to big companies not simply because the pay is better (it usually is) or the opportunities greater (they usually are), but also because they are the principal learning and training grounds of Canadian commerce. As such they provide many of the men and women who eventually become the senior managers, general managers and presidents of smaller Canadian companies.

Quite apart from the many community and social benefits which derive from big Canadian corporations, there are the benefits of being able to tackle national development projects, which if they could not be handled by Canadian corporations, would mean the importation of skills and expertise from other countries, with a consequent loss in Canadian national growth, income and employment.

The merits of mergers and acquisitions

There are two principal methods of growth open to any corporation:

- internal expansion
- merger and acquisition (to diversify or enlarge an existing organization).

To put it another way: a company can build on what it has or it can add to what it has.

For large companies, such as Northern Electric, the acquisition route is usually taken to:

- enlarge share of a particular market
- obtain a new product line without having to follow the longer route of internal product development
- obtain a position in a new market (to permit quicker introduction of a new product line or to eliminate the time usually necessary to build a market position)
- diversify into new areas of corporate activity.

For small companies, their merger with another company or their acquisition by a larger company is often dictated by the need for capital to maintain growth. The supply of capital in Canada is limited and there are a limited number of Canadian companies with the resources to make acquisitions that are attractive to the shareholders (or owners) of the acquired company and to provide the acquired company with the capital necessary to permit it to continue to grow.

Merger and acquisition are an essential part of growth in the western industrial society. For a company that has reached its peak of growth from internal resources and which cannot obtain capital from normal banking, financial or equity sources there are only two routes to go: merger with, or acquisition by, another company that can provide the necessary capital or other avenues for growth *or* slowly downhill as it is overtaken by more capital-rich competitors or its market is taken by larger companies. Rarely does such a capital-hungry company succeed in maintaining its sales and earnings indefinitely.

Obviously all acquisition candidates do not fall into this category and some companies are sought out as acquisitions to satisfy the expansion needs of the acquiring company. However, it should be noted that no company can be acquired without the active consent of its owners or shareholders and the offering or tendering of their shares — whether this is done as a normal trade on a recognized stock exchange or in response to a cash or tender offer.

Under the existing regulations and safeguards established by the major stock exchanges in North America it is difficult, if not impossible, for a company to be acquired against the wishes of a majority of the shareholders — though it could be acquired against the wishes of the professional management or even of the board of directors (unless control rests with either group).

If the management or the directors dislike a tender or acquisition offer the views of the management and the acquirer are debated in public, through the financial media, or in correspondence between management and shareholders and the acquirer and shareholders. The advantage in such a debate rests with the incumbent management or board, assuming it has been operating the company effectively and profitably and can indicate a future brighter than that offered by the potential acquirer.

Northern Electric believes that the route of acquisition is a recognized, acceptable method for a company to grow and to expand into new activities. The company has an aggressive acquisition search underway directed by a senior management group. It is questionable whether it will make acquisitions in Canada, but it will probably seek companies to acquire in several of the international markets which it is now penetrating or seeking to penetrate.

It is, however, possible that Northern Electric's wholly-owned distribution company, Nedco (1975) Ltd., will make further acquisitions as it grows and consolidates its position in key markets across Canada. It also is interested in acquisitions in international markets where it can logically and profitably expand its operations.

Restraints to growth

In case there is any misunderstanding on the part of the commission's audience, it is perhaps worth stating here that growth is not automatic and that there are more restraints to growth in Canada than there are stimulants.

Without attempting to establish any order of importance or impact upon growth, the following are some restraints to growth in Canada:

- the smallness of the market
- the proximity of the United States manufacturing industry
- competition, from domestic and foreign companies and products
- Canadian tax structure
- low level of labor productivity
- high wage rates
- long distances and high transportation costs
- the availability and cost of capital
- competition for management provided by U.S. companies
- government regulation.

When viewed against the tax policies of the United States, the higher level of productivity in that country and the more statesmanlike attitude of its union leaders towards wage rates, the performance of Canadian companies speaks well for the skills of their managements.

In contrast it is hard, if not impossible, to identify any restraint to the growth of government. Even changes in the political parties in power do not seem to diminish the fires of expansion — probably because they are now deeply rooted in the bureaucracies of the various governments, and these bureaucracies do not change.

Even in the worst depression the country has seen since the 1930s, federal government expenditures and payrolls continue to grow in dollars and numbers of employees.

While there appear to be no restraints to government growth, there are two restraints to the growth of unions, neither of which is regulatory:

- the ability of business and industry to create and maintain jobs
- the ability of union spokesmen to convince Canadians that their best interests will be served by union membership.

The ability of business and industry to generate employment is currently only a small limitation on union growth, as its major advances — in membership and increases in income — have been outside industry, in the government public service.

Northern Electric and world telecommunications market

Northern Electric is a Canadian-created, Canadian-managed and Canadian-owned company. In Canada, it is a rarity. It is an electronics company that seeks no government support or subsidy. It is large, profitable and successful not only in Canada but in international markets, particularly the United States. It is currently selling its products at an annual rate in excess of one billion dollars a year.

Northern Electric is the largest manufacturer of telecommunications equipment in Canada. It is the largest manufacturer of electronics, electronic systems and electronic components in Canada. It is the largest plastic moulder and the largest maker of wire and cable in the country.

In association with Bell Canada, Northern Electric maintains the largest independent industrial research organization in Canada. One of the company's subsidiaries is the largest distributor of electrical, electronic and industrial products in Canada.

These statements are made not to impress the commission, but to make one point: Northern Electric's success as one of Canada's few international companies is based upon size; the size of itself and of its parent, Bell Canada.

Northern Electric came into being in 1882 as a small department of the Bell Telephone Company of Canada, set up to manufacture telephone sets. It was incorporated under its present name in 1914.

Northern Electric grew along with its parent, Bell Canada. It benefited from Bell Canada's size not only in terms of the market that the company represented, but also in terms of the range of product that Bell needed and that Northern Electric was called upon to design and manufacture. It benefited most significantly from Bell Canada's ability to provide the capital necessary for sustained growth.

The company benefited also from its association with Western Electric and Bell Laboratories in the United States — respectively the largest telecommunications manufacturer and largest non-government telecommunications research establishment in the world. Western Electric held 44 percent of Northern Electric common stock until 1956: thereafter Bell Canada bought out Western Electric's interest.

The technology obtained from Western Electric and later, its own expertise and skill in the design and manufacture of telecommunications equipment enabled Northern Electric to become the principal supplier to the majority of the major Canadian telephone companies.

It appears to us to be an incontestable conclusion that, if Bell Canada had not had the foresight, determination and resources to foster the growth of Northern Electric, Canada today would be a captive market for U.S. and other international manufacturers of telecommunications equipment.

The quality of service of the telecommunications — and particularly the telephone — industry is taken for granted in North America. It is the best in the world and the objective of most other countries is simply to equal it. It is not only the best in the world in terms of service and equipment used, but it is also the cheapest in terms of cost to the consumer.

Some of the best equipment (technologically and in manufacturing quality) and cheapest (in terms of cost to the telephone company and its subscribers) is being made today, here in Canada, by Northern Electric.

This superiority is attributable to the large investment Northern Electric and Bell Canada have made, and continue to make, in research and development, primarily through their research affiliate, Bell-Northern Research Limited, near Ottawa. BNR is currently operating at an expenditure level in excess of $50 million a year — just slightly less than Northern Electric's total net earnings in 1974.

The scale of research and product development required in the telecommunications industry to maintain leadership in technology and in service to the consumer and to obtain a share of the world telecommunications market can only be developed by large companies.

Northern Electric is able to support this level of research and development not simply because it is large, but because it is large and profitable. Size without profitability makes no contribution to the Canadian economy, the development of the Canadian identity or its culture.

Size with profitability generates employment and stimulates the economy with its ripple effect. Northern Electric's ability to finance the creation of subsidiaries in other countries and to establish manufacturing facilities in those countries, increases Canadian exports and Canadian employment.

This is because Northern Electric's foreign subsidiaries are dependent upon the Canadian operations for components, product lines and technical expertise in many areas.

Telecommunications is one of the world's largest industries on the basis of capital employed and total number of employees. It is international in character and is dominated by a number of large companies (see Appendix A).

These international corporations have their home bases in the United States, England, Sweden, Germany, France, The Netherlands and Japan. Among them are some of the world's largest corporations. Many of them are represented in the Canadian market by sales and/or manufacturing subsidiaries.

With the exception of Northern Electric and the Japanese companies, all of these international competitors of Northern Electric's have entrenched positions in the European markets. In competition with such corporations there is no room for a small company and no place for a purely national company.

In the western industrial world the idea of what constitutes a free enterprise capitalist economy takes many forms — and nowhere more so than in the world telecommunications industry.

Only in the North American markets of Canada and the United States — with technologically compatible systems — can it be said that there is a "free" or "open" market for telecommunications, i.e. a market in which the telephone system is generally investor-owned and in which all may compete without preference on reservation. Even this is true only to a degree. For instance, in the United States the Rural Electrification Authority, the federal government agency, which provides loan capital to small, independent (non-Bell System) telephone companies, requires a majority of the product to be of U.S. content. This is one reason why Northern Electric now has five manufacturing plants in the United States.

Outside of North America — and particularly in Europe — the telephone systems are operated by the government, usually the post office. The quality of service, equipment and the size of the deficits, are similar to that of the national mail services.

Under government ownership the national telephone authority designs equipment and each nation has its own protected manufacturing sector producing equipment to government-designed standards. With each nation producing its own individually-designed equipment, there is no export business, except to former colonies or Third World nations. There is often little technological compatibility between the systems of each European country.

This situation has created a market for Northern Electric, L.M. Ericsson of Sweden and other aggressive internationals because the government-chosen manufacturers in these countries cannot supply modern electronic equipment fast enough. Additionally, the cost of the European equipment is high by North American standards.

Entry into these European markets is conditional upon acceptance by the government concerned, either as an individual manufacturer or an associate of an establishment company in that country. Manufacture within the country is a mandatory requirement for any company that is attempting to create a large, long-term market penetration. Ericsson, for instance, has plants in 14 countries and designs equipment for all markets. As Northern Electric gains entry to more of these markets, it too will design equipment specifically for their needs.

This is a role, however, that can be played *only* by a large company with strong financial resources, a history — and a future — of success in technological development and innovation and with a management capable of working in an infinite number of national economic and telecommunications environments.

The ultimate irony

Earlier in a discussion of restraints to corporate growth in Canada we noted (paragraph 43) two items: low level of labor productivity and high wage rates.

First, let us establish that as a company Northern Electric believes a national goal should be the highest possible level of employment with the highest wages that the economy can support.

Today, however, we are paying wages higher than the economy can afford or support.

This, of course, is not news. The former federal Minister of Finance, John Turner, the former Minister of Trade and Commerce, Alistair Gillespie, and the prime minister have all warned of the potential negative impact on the Canadian economy of wage rate increases that continue to run at more than twice the level of wage increases in the United States.

An independent study (by R. J. Wonnacott) at University of Western Ontario, for the Economic Council of Canada, indicates that Canada's level of labor productivity, historically lower than that of the United States, is still 21.3 percent lower.

Labor Canada (Allan Porter, chief of wages research division) says that the hourly earnings of Canadian manufacturing employees now exceed those of their counterparts in the United States.

In December 1974, the earnings of Canadian manufacturing employees were nine cents an hour or 1.9 percent higher than the comparable U.S. figure. There is every reason to believe that this gap has widened in the first two quarters of 1975.

In contrast, at December 1973, the U.S. average was 16.4 percent higher than the Canadian average.

Labor Canada said, "The much more rapid increase in Canadian wages and salaries combined with poorer productivity performance in 1973 and only a slightly better one in 1974 resulted in an increase in unit labor costs in manufacturing of 23.9 percent in Canada and of 14.9 percent in the U.S. between the first quarter of 1972 and the fourth quarter of 1974". The information available to us would indicate that this condition has continued to deteriorate in 1975.

In essence, *Canadians* are being *paid more* to *work less effectively* than their counterparts in the United States. All other factors being equal this means that it is cheaper to produce any given item in the United States than it is to produce it in Canada.

One of the reasons Northern Electric established manufacturing plants in the United States was to enable it to be competitive on a cost basis in that market.

At time of writing, three of the company's U.S. factories (located in three different states) have wage rates below those being paid at three company factories in Ontario producing the same products. Based on the highest starting rate, wages paid in the three Canadian factories are from $1.25 to $2.05 higher than those paid for comparable work in the U.S. factories.

If the current erosion of the Canadian competitive position by high wage rates and low productivity continues, the nation may be faced with the ultimate irony: Canadian companies establishing plants in the United States so that they may compete in the Canadian market.

Summary

There is great emphasis given to the "public interest" in the commission's terms of reference. This is a vague, undefined and ambiguous term open to an infinite number of definitions and interpretations. We suggest, as a definition, that the commission might wish to view the "public interest" as that which is to the advantage, profit or benefit of the majority of the nation; in other words, the *national* interest.

Canada is a trading nation and its future depends to a large degree upon its ability to expand its trading activities throughout the world. It is our strong feeling that the commission's investigations into corporate size and concentration must take place against the world background of the competitive needs of Canadian industry in international trade and not simply against the infinitely smaller panorama of the Canadian economy and society. If it is not, then the Canadian long-term national interest may be sacrificed for an imagined short-term public interest.

In the drive by Canadian companies to form corporate structures capable of competing on the world scene with large international companies based in other parts of the world, we believe mergers and acquisitions to be an essential and necessary part of the normal growth pattern. The ability of relatively small countries to accommodate large international companies is illustrated by the presence of Philips Industries, Royal Dutch Shell and Unilever in The Netherlands, of Nestlé in Switzerland and L. M. Ericsson in Sweden. These are all globe-girdling organizations. None, from the outside, appear to be threats to the democratic structures of the countries in which they are based.

There is a suggestion, contained in the very existence of the commission, that growth for Canadian corporations comes with relative ease. On the contrary, we believe that there are infinitely more restraints to the growth of corporations in Canada than there are stimulants. We also believe that the commission could provide a national service by examining and reporting on the growth restraints that face Canadian corporations compared with the stimulants and encouragements that are the lot of companies from other nations with which Canadian industry competes.

Size is a corollary of being competitive and successful in international markets. Northern Electric would not be able to compete effectively in international markets — no matter its technological strengths — if it was a small company. Northern Electric's size is also Canada's best defence against its national telecommunications equipment market becoming a captive market for the large international companies based in other countries which supply other areas of the world market. Northern Electric's ability to design, develop and deliver superior equipment at competitive prices to telephone companies throughout Canada is not something that could be duplicated by a number of smaller Canadian companies competing against large international companies based in the U.S., Europe and Japan.

The biggest threat to Canada's ability to defend and supply its domestic markets comes not from international companies, but from its own workforce. With a number of key industries faced with the knowledge that they are paying higher wages for lower productivity than their competitors in the United States it is simply a matter of time before we are faced with the alternative of tariff barriers or loss of domestic markets. It will be necessary in some industries not only to curtail the current wage spirals but also provide a pause in Canadian wage growth to permit the U.S. scales to catch up. If this cannot be done then some Canadian manufacturers may be faced with the unpalatable fact that if they are to remain competitive in their own market they will have to manufacture in the U.S.

October 31, 1975.

APPENDIX A

Major international manufacturers of telecommunications equipment competing with Northern Electric

Company	Country	$ million fiscal year 1974 Total Sales	Telecommunications Sales
ITT	U.S.A.	11,200	3,000
Philips Industries, N.V.	Netherlands	9,700	N.A.
*Western Electric	U.S.A.	7,400	7,400
Siemens	West Germany	6,600	1,600
Hitachi	Japan	5,800	844
AEG Telefunken	West Germany	4,900	N.A.
RCA	U.S.A.	4,630	195
General Electric Company Ltd.	U.K.	3,400	760
Cie générale d'électricité	France	3,400	635
British Insulated Callender Cables	U.K.	1,800	Cable only
Nippon Electric	Japan	1,540	1,230
L. M. Ericsson	Sweden	1,500	1,300
N.A. Philips Corp.	U.S.A.	995	348
Thomson-CSF	France	990	N.A.
Northern Electric Company, Ltd.	Canada	971	813
Plessey	U.K.	955	500
Fujitsu	Japan	826	250
S.T.C.	U.K.	774	N.A.
GTE — Automatic Electric	U.S.A.	700	700

*Western Electric is not international but has been included to illustrate the size of competition in the U.S. where it is by far the largest telecommunications manufacturer.

October 31, 1975.

In Japan the government, labor and management are collaborating to develop an economy that is acquiring awesome momentum in world markets.

"Japan, Inc."— The Total Conglomerate

JOHN C. LOBB

THE major trading nations are today engaged in worldwide economic warfare. The chief adversaries are the United States, Germany and Japan. The outcome of this conflict is not clear, but it cannot fail to have far reaching impact on economic theories, political institutions and business, particularly on those of the United States. This war did not start with a dramatic Pearl Harbor that united the American people. It has been a steady, insidious type of economic invasion.

At first the Japanese invasion was limited to electronics and optics. Germany began shipping a few Volkswagens in the late 1950s. All this was watched with condescension by U.S. industry. It was clear to complacent management and government that no important markets could be captured by what is still called, in complete ignorance, "cheap foreign imports."

The fundamental fact ignored by Washington and U.S. industry alike is this: a major challenge to U.S. labor, management and capital has been mounted. It is not based on cheap labor. It has been effected by a completely different form of capitalism. The political state, organized labor and capital have joined hands in Germany and Japan. The power of this combination is being felt all around the globe. If the United States cannot adapt to or cope with new management concepts, implementation and legal theories, it faces a serious decline as a world economic power. This may not mean, as Hacker predicts, an "end to the American Era." However, basic changes in business-government-labor relations and in management thinking are required for a counterattack. Japan de-

serves the most attention because it is the most interesting, although many elements of the Japanese "Zaibatsu" concept exist also in Germany.

The effect of these efficient operations will continue to alter world economics and may well affect the Soviet Union even more than the United States. The Russian economy is not as strong as that of the United States. Its internal transportation system is incredibly weak. While the U.S.S.R. is relatively self-sufficient, like the United States, it needs world trade. Most embarrassing to the Soviet, for example, is the relative increase in per capita ownership of automobiles and appliances in the satellites, even in devastated Poland. The two most powerful military powers in the world are facing severe economic competition without the muscle of modern economic weapons to fight back. Neither conventional capitalism nor conventional communism may be adequate for the commercial challenge of the 1970s.

The Current Scene

Take a look at a few major industries:

Automotive: In 1969, for the first time in history, more automobiles were produced outside the United States than within that country. Soviet production is still negligible—even less per capita than Poland. The combined production of the European Economic Community (with the United Kingdom included) can be expected to pass the United States easily by 1980. Japan's production is now at a rate of 3,000,000 cars annually. This will continue to grow, but in world markets the Japanese will encounter more competition from Europe than from the United States. Even so, Japan will continue with the fastest growth rate in the industry for some years.

Chemical: This industry has long been the greatest single source of U.S. favorable balance of payments. It is a strong industry based on good technology, cheap naphtha from petroleum and a huge local market. The American Selling Price system has protected some companies from foreign competition but has hurt others. In chemicals, too, Japan now has the fastest growing group of companies in the world.

Steel: Nippon Steel, a Japanese government-sponsored merger of Fuji Steel and Yawata Steel, is now the world's largest steel company. The Japanese steel industry, literally bombed out in World War II, produced about as much steel in 1950 as a single small U.S. producer. Today Japan has surpassed the United Kingdom, France and Germany in terms of total production. By 1972, Japan will produce more steel than Germany and England combined by a big margin. By 1980 Japan will outproduce the entire EEC. The U.S. steel industry is in severe straits. Only a series of mergers, perhaps ordered by the U.S. Government, can permit survival of some units.

Electronics and Optics: Japan is best known among U.S. consumers for electronics and optics: radio, TV and cameras. Sony is a familiar brand name in the United States, but Sony is only the sixth largest producer of electronic equipment in Japan. What caused this truly fantastic industrial growth in a country of 100,000,000 people crowded into a smaller area than California? Obviously, it was not the U.S. unions' cry of "cheap labor." If cheap labor made an industrial nation, India would overpower Japan. Women work in Indian steel mills for 30¢ a day. Wages generally are a fifth to 1/10 of those in Japan. The fact is that Japan leads the world in innovative electronic engineering.

Japan is not only a leader in consumer electronics. One company, Nippon Electric, may be the world's largest producer of integrated circuits, about 2,500,000 a month. In microscopes, field glasses and optical electronic gear the Japanese have long since passed the United States and Germany. While Eastman Kodak alone challenges Japan for the world camera market and dominates only in film sales, Fuji is becoming a true competitor and is entering the U.S. market.

Shipbuilding: Japan is the world's largest and most efficient builder of ships. There would be no U.S. shipbuilding except for heavy government subsi-

dies. Norway and Holland are efficient but small by Japanese standards. The best customers of Japan are the big international oil companies. Japanese shipbuilding is closely tied to the Japanese steel industry. Vertical integration is considered logical and is encouraged by law.

The Zaibatsu System

No foreigner will ever be given access to the inner workings of a Japanese zaibatsu or "Group," as it is now called. But there is reasonably accurate knowledge of how and why "Groups" work. In the first place, the Japanese zaibatsus were the first and most successful conglomerates. Detractors of conglomerates should study well the history of these institutions. It may be that U.S. conglomerates were simply not allowed to go far enough and did not have active government support. The U.S. conglomerates, which have largely made a constructive contribution, might have expected attack from the left but were hardly prepared for assaults by the Establishment!

The word "zaibatsu" means "money group." The connotation is exact, because at the top of the pyramid is a major bank. The three largest are Mitsui, Mitsbishi and Sumitomo. They were officially broken up by General MacArthur but are now "loosely associated" again, according to official Japanese statements. In practice, the members of the group work closely together, and working control of 20 to 30 major companies is held by the group bank. In addition, each controlled company may have minority interests in over 100 so-called "sister companies." Unofficial or official, the Groups are tough competition around the globe.

A typical zaibatsu will own a major steel company and chemical company and also control large companies in textiles, oil, machinery, mining, electronics, shipbuilding, insurance and so on. By way of comparison, imagine a single U.S. conglomerate including Westinghouse, Union Carbide, Continental Oil, Phelps Dodge, Ingersoll Rand, Republic Steel and Aetna Insurance, plus dozens of smaller companies. Imagine further that all this in turn were controlled

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by the First National City Bank. This will give a rough idea of the corresponding make-up of the Sumitomo group, as one example.

These Japanese conglomerates are over 100 years old and still growing. Their trading companies operate in every nation of the world, including the Soviet Union and Mainland China. They ruthlessly govern expansion of their own component parts, through the group bank, by allocating or withdrawing credit. Weak members simply disappear as funds are denied by the controlling bank, or by direction of the all-powerful MITI, the Ministry of International Trade and Industry.

In world trade, the flexibility and power of these combines is awesome. No antitrust laws impede their rationalization. In some cases, the great zaibatsus themselves still combine to bid on major international projects. The government not only encourages this type of effort, but supplies funds through the central bank, the Bank of Japan. A corresponding U.S. situation would exist if the Justice Department blessed a joint bid of U.S. Steel, General Motors and DuPont and loaned the consortium money through a branch of the Federal Reserve Bank! This is the kind of economic war being waged; these are some of the weapons.

The Government's Role

Much has already been written about the partnership of industry and government in Japan. In many ways the government is much more involved than in the United States. MITI has great powers. Literally, MITI plans the business strategy of Japanese industry in world markets. The Ministry decides which indus-

tries will expand, and it directs the Bank of Japan to provide funds to Sumitomo Bank, Fuji Bank or whatever the parent bank may be in order to permit expansion. There is no reckless competition for markets between Japanese companies in foreign markets. Only in Japan itself does free competition exist. The Japanese and the Germans both regard the U.S. passion for competition as naive, inefficient and wasteful of capital. Since the United States is losing the international economic ball game, it may be time to reexamine some of its more cherished theories.

The Japanese government also has maintained a tacit partnership with the major labor unions. It is normal to read, for instance, that the government had decided steel workers should get about a 12% increase, and that the unions and the managements agreed this was about right. All this is done quietly by negotiation. Unlike U.S. practice, a productivity increase is decreed simultaneously. There has been no major Japanese strike since World War II, yet standards of living go up geometrically. While foreign businessmen talk of "coolie wages," the Japanese worker buys more cars, TV sets and appliances per capita than any worker in the world outside of North America.

Japanese who have spent much time in the United States talk freely about the close working relationship of management, labor and the government. It is designed for the benefit of the country. They call the whole interrelated system "Japan, Inc.," and for good reason. Technology, manpower and capital are marshalled to invade world markets as a single entity. It is a fascinating and at the same time a frightening phenomenon. Only in time of war does the United States operate this way. The Congress and most of its industrial management have ignored the developing competition. The strongest monopoly, the U.S. labor unions, exempted from the antitrust laws, are permanently destroying jobs by destroying international competition. Protectionism is an economic mistake—practiced in the wrong war.

No system ever works unless it fits the mentality of the people. The Japanese business system is perfectly suited to Japan. The Japanese really do put country and family ahead of self. This may change, but the world faces a driving, united Japan in the 1970s. A regular program of 12% wage increases can be planned without concern over inflation because the increase in labor productivity is programmed at 15%—and it is attained. Only in wartime has the United States had remotely comparable utilization of all its resources. But the Japanese are doing it for economic warfare, and U.S. and European competitors are finding it painful.

The Japanese have the world's most literate population. The educational system beyond the secondary schools is strictly elite. Competitive examinations are required. There is no nonsense about "higher education for all"—the Japanese cannot understand the idea of assuming equal ability to learn.

There is a fanatical devotion to Japan and to the job to be done. In World War II, the Allied armies saw the dedication of a people facing hopeless odds. In economic war, because of its determination to be first in world markets, the odds are shifting to Japan's favor in several basic industries. Japan has no race problems of any kind. The only aristocracy is that of business achievement. Class warfare seems psychologically improbable, because of the universal dedication to "Japan, Inc."

Anti-Trust Implications

In comparison, the United States is losing position in world markets. Its trade balance is weak. Except for coal, soy beans and certain basic chemicals, it would run a permanent, chronic deficit. In the face of rising inflation it is turning more to protectionism. Are some fundamentals being overlooked? Can the U.S. economy fight a world economic war with obsolete weapons? Consider first the Sherman Act and the Clayton Act. They are literally horse and buggy concepts, since the Sherman Act (1890) and the Clayton Act (1916) preceded the development of the automobile. The continuation of these concepts in a world economy played under different rules displays the "old Maginot Line mentality." This is only one example of living in the past. The Interstate Commerce Commission was established in 1888 to protect the consumer against a railroad monopoly of

transportation. After 92 years it is not surprising to find a highway contractor-truckline-gasoline complex dominating transportation in the United States. Japan has come into the last quarter of the 20th century with government planning that makes transportation an efficient tool of industry and of the people. The railroad line between Osaka and Tokyo has a gross revenue of $38,000,000 *per month,* with 16-car trains every 20 minutes giving efficient, high-speed passenger service.

In all the current discussions in Washington about foreign import threats, there is almost no mention of the legal chains that keep U.S. industry from competing in foreign markets. The facts are clear: no nation can afford the luxury of imposing shackles on its industry engaged in world trade when the other powerful nations play by different rules. We would need no quota legislation if we turned our industry loose, as the Japanese government does. In a perfect world, pure "free trade" would be automatic. There is not going to be any perfect world, and the Japanese understand this as a fact of life.

Why the System Works

The Japanese system has worked for about 100 years under its present form. Its success cannot be ignored any longer. Consider a nation with fewer natural resources than Tibet or Bolivia and 100,000,000 people compressed into small islands, which nonetheless is threatening the economic power of the United States. It is also worth recalling that this nation was more completely devastated by conventional and atomic bombs than any other nation in history. Only 25 years ago, Japan had no factories, no foreign credits, no transportation system. The economic renaissance is beyond that of West Germany. Here is another vital point: the German system has many of the same characteristics as Japan's—about 30% of German industry is owned by a few banks, for example. How much longer can the United States continue complacently to insist that there is only one way to run an industrial nation?

Long-time observers believe first of all that there are some fundamental Japanese character traits to consider. First, there is less individualism. There never was a frontier to escape to. Conformity is essential. There exists a fanatical devotion to the country and to the employer also. At one of Japan's greatest companies, Matsushita Electric, every day begins with the singing of the company hymn. The greater glory of the company and Japan, rather than individual advancement, are the primary objectives. There is a regimentation even in the schools, where children march to class in uniforms. Not surprisingly, Europeans have long called the Japanese the "Prussians of the Orient." It is apt. Like the Prussians, they are coldly efficient, deadly in perseverance and thoroughly dedicated to the proposition that they will one day be the world's first power.

The Japanese now graduate more engineers from universities than any other nation in the world. Their literacy rate is by far the highest of any country. The educational system calls for roughly twice as many classroom hours as U.S. schools, even at the grade school level. The system is highly competitive, and university admission depends on rigid examination. Higher education belongs to the educational elite, with the government paying all the bills. Those who do not pass the examinations go to vocational schools. This educational concept does not conform to current U.S. thought, but this is the competitive world with which we must compete, or decline as the British have declined.

Surely the Japanese system of capitalism is different from ours. There is a higher degree of personal savings, but less opportunity for the individual entrepreneur. Yet some of the great success stories of the last 50 years, Matsushita and Sony, were created outside the zaibatsu system. If there is a single noticeable change, it is in the willingness of the great banks to aid the new company, rather than "encourage" a merger with a bank-owned subsidiary. Over everything is the insistence that what is best for Japan will be done. Remember the famous quote of Charlie Wilson, former G.M. president, who allegedly said "What's good for General Motors is good for the United States"? In Japan, such a statement would have been accepted as a simple truism: what's good

for Mitsui is automatically good for Japan, in the eyes of the people.

Japanese bankers and industrialists cannot understand the U.S. arguments against the conglomerate. To them, the flowing of capital into varied industries, moving resources and manpower back and forth as markets dictate, is the only way to run a world business. Neither size nor control by banks has the slightest connotation of evil. Under this system, the Japanese people have risen rapidly to a standard of living surpassed only by two or three countries. In no Japanese election has there been any issue of the system. It is as acceptable as the Rising Sun.

The Japanese think in terms of world markets, not domestic markets. They see the obsolescence of one industry being made up by the growth of another as the normal way to plan capital expenditures. To build more obsolete plants to produce for a failing world competitive position would seem absurd to a Japanese, even if the Central Bank would allow him funds. For example, the Japanese regard the current row over textile imports as a passing thing. The textile industry is in decline; it cannot earn vast exchange as can the automobile industry or electronics. But, as in the United States, textiles are politically potent just now and will be supported until the workers are moved to new industries.

Capitalistic and Unique

Japan is clearly a capitalistic country. In spite of a high degree of government interference (called "direction" in Japan), there is no sign of a growing interest in Communism. The Japanese farmer is devoted to his little plot of land. The cultivation of excellence, of intellectual survival of the fittest, does not suit a state bureaucracy. As a matter of fact, the Japanese, who think in terms of centuries like all Orientals, do not expect Communism to last in its present form in the Soviet Union or in China. They see it rather as an inevitable reaction to incredibly bad government.

Japanese capitalism is unique in that the individual entrepreneur is limited by MITI in his funds for expansion. In the United States, any businessman is free to look for new sources of funds if his bank turns him down. It is much more difficult in Japan. The banks speak for the state, although owned by private capital.

The Japanese system reflects a different concept of management, with ultimate control resting with banks instead of manufacturing companies. Any efficient corporation determines objectively, at the corporate level, the capital program of its divisions. In Japan, the decision is truly objective since capital is allocated by the bank in control, and the government "advises" the bank on major capital programs involving foreign trade.

No one knows how effective a trade war is. It is subtle and less likely to arouse any strong united opposition. How many voters would support a 50% tariff on Sony radios or Volkswagen cars? The consumer will always outvote the manufacturer.

Von Clausewitz said that war was only the extension of political aims by force of arms. Does it not follow that economic warfare is a modern method of extending political influence? It is interesting to speculate on what might have happened if Japan and Germany had used their great manufacturing and trading power to conquer Europe and Asia in 1941 instead of using bombs.

Surely the Japanese economic system is one that has developed awesome momentum. It deserves closer study by U.S. industry, the university graduate schools of business and most of all by the U.S. Congress, the State Department and the Justice Department. The United States has clearly lost the early battles of this war. Will it allow its industry to have the tools to fight back? Or will it go the way of other formerly potent industrial nations?

The Prospect: Tougher Competition

The United States is losing an economic war, yet labor leaders, industrialists, bankers and the Congress seem unconcerned and complacent. Decades of prosperity have persuaded all too many people that the United States will continue to dominate world

commerce. In fact, however, its trade and its currency are in trouble. Businessmen cannot afford to ignore the management methods and the governmental actions of nations like Germany and Japan. Some ways of doing business may have been suited to the 19th century but not the 21st.

If the United States expects to be competitive again —and it can be—it must play by the same ground rules as Japan and Germany. This means rewriting obsolete antitrust laws and creating a U.S.-type MITI. The labor unions, clearly the strongest monopoly power in the United States, must be made subject to the new antitrust laws.

Finally, the United States must get rid of the old liberal concept that "free trade" will solve all the problems. There is no "free trade." Trade has become a national weapon of economic warfare in the hands of MITI. The zaibatsus and their German counterparts are effective weapons in the multinational world of tomorrow. Just as the Japanese have copied many U.S. practices, the United States should consider adopting and modifying some from that country. That may be the only means of survival as a major world power.